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No. 87-985

IN THE

Supreme Court of the United States

OCTOBER TERM, 1987

FINA OIL AND CHEMICAL COMPANY, *et al.*,
Petitioners,

v.

EL PASO NATURAL GAS COMPANY,
Respondent.

On Petition for a Writ of Certiorari to the Court of Appeals for the First Supreme Judicial District of Texas

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PETITIONERS' REPLY BRIEF

CHARLES M. DARLING, IV
STEVEN R. HUNSICKER
JOHN P. BABB
BAKER & BOTTS
555 13th Street, N.W.
Suite 500 East
Washington, D.C. 20004-1109
(202) 639-7700
Attorneys for Petitioners

[Additional Of Counsel Listed Inside]

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

Of Counsel:

FINA OIL AND CHEMICAL COMPANY
SCOTT SHELTON
P.O. Box 2159
Dallas, Texas 75221

CHARLES W. COLWILL,
ANNE HOME EMERSON, TRUSTEE,
ANNA LOU HOME,
TERESA HOME,
CASSANDRA KEYSER,
JEAN F. KEYSER,
BARRON KIDD, AND
HELEN ULMER VAN ATTA,
EMORY T. CORBETT
Suite 500
Two Turtle Creek Village
Dallas, Texas 75219
(214) 528-6174

MORRIS AND FLORA MIZEL
LIONEL E. Z. COHEN
309 Philtower Building
Tulsa, Oklahoma 74103
(918) 583-6211

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PETITIONERS' REPLY BRIEF

INTRODUCTION

Respondent's Brief in Opposition sets forth two basic arguments for denial of the petition filed in this cause. First, Respondent argues that the judgment of the Texas Court of Appeals was based solely on state law and did not draw into question any federal statute. Second, Respondent argues that even if the judgment of the court below presents a federal question, the petition should be denied because the question of federal law is only of "academic" interest.

As shown below, Respondent's arguments cannot withstand analysis. The judgment of the Texas Court of

Appeals is predicated upon an interpretation and application of federal law, as Respondent itself argued below. Second, the state court's interpretation and application of federal law not only threatens to destroy Petitioners' property rights but also creates a fundamental conflict between federal and state authorities construing the federal statute at issue. Third, the state court's judgment refuses the appropriate preclusive effect to which a prior judgment of the United States Court of Appeals is entitled.

Granting Petitioners' writ is entirely appropriate under these circumstances.

ARGUMENT

1. The State Court's Decision Below Was Predicated On An Interpretation And Application Of Federal Law.

In its Brief in Opposition, Respondent mischaracterizes the case below as involving exclusively state contract law.[1] As the Texas court's opinion demonstrates, the holding of the state court was dependent upon the court's interpretation of the Natural Gas Policy Act of 1978 ("NGPA"),[2] and the state court's reading of *Public Service Comm'n of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983) [hereinafter *"Mid-Louisiana"*]. *See El Paso Natural Gas Co. v. American Petrofina Co. of Texas*, 733 S.W.2d 541, 545-46 (Tex. App.—Houston [1st Dist.] 1986, writ ref'd n.r.e), App. 1a, 4a-6a.[3]

The state court's opinion further demonstrates that the federal issues were of primary importance. Prior to even reaching the contract issue—whether Respondent

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[1] Brief in Opposition at 2.

[2] 15 U.S.C. §§ 3301, *et seq.* (1982).

[3] Citations in this Reply Brief to the Appendix to the Petition for Certiorari are cited as "App." Citations to the Supplemental Appendix attached to this Reply Brief are cited as "Supp. App."

was entitled to terminate Petitioners' royalty interests in properties pursuant to a so-called "unprofitability" contract clause[4]—the court necessarily addressed Respondent's claim that the NGPA, as interpreted by this Court in *Mid-Louisiana*, required interstate pipelines to abandon cost-of-service pricing in favor of producer-parity pricing. The court was required to resolve this issue because Respondent claimed that this change in federal law had rendered the properties unprofitable and Petitioners' royalty interests therefore subject to termination under the agreements at issue.

In fact, Respondent represented before the state court that the interpretation and application of federal law was central to this controversy. In its brief to the Texas Court of Appeals, Respondent argued that "unprofitability occurred only because of the Natural Gas Policy Act of 1978 as definitively interpreted by the United States Supreme Court [in *Mid-Louisiana*] in 1983."[5] Respondent further represented to the court below that the controversy would not even exist but for the NGPA and *Mid-Louisiana*.[6]

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[4] Similar arguments were raised in connection with a "noncommercial acreage" clause. App. 6a.

[5] Reply Brief of Appellant El Paso Natural Gas Company at 2, Supp. App. SA-5.

[6] In its initial brief, Respondent made the following assertions:

> This declaratory action would not have been filed, nor would the present controversy among the parties exist, were it not for the occurrence of two events totally beyond the control of the parties.
>
> First, the Natural Gas Policy Act of 1978 (15 U.S.C. § 3301 *et seq.*) ("NGPA") was enacted by Congress and signed into law by the President. . . .
>
> Second, the United States Supreme Court held [in *Mid-Louisiana*] that the maximum lawful price provisions of the NGPA were applicable to natural gas produced by interstate and intrastate pipelines from their own wells, even though that

The judgment of the Texas Court of Appeals is based upon that court's acceptance of Respondent's own arguments as to the applicability of the NGPA as interpreted by *Mid-Louisiana*. *See* 733 S.W.2d at 545-46, App. 4a-6a. Respondent cannot now argue in good faith that the state court's judgment was not based upon a federal question.

2. The State Court's Interpretation And Application Of The Determinative Federal Issue Was Incorrect And Inconsistent With Federal Authority.

The foundation of the state court's holding below was that Respondent necessarily abandoned cost-of-service pricing and, as a result, the properties became unprofitable by operation of federal law.[7] Respondent's assertions to the contrary are unfounded.[8]

> gas moved into the pipeline without a traditional "sale" having occurred; thus, the intercompany transfer from a pipeline's production division to its transmission division [*e.g.* GLA production] was sufficient to render pipeline production subject to NGPA price ceilings . . . .

Brief of Appellant El Paso Natural Gas Company at 6, Supp. App. SA-2. (Footnotes omitted).

[7] *See* 733 S.W.2d at 545-46, App. 4a-6a.

[8] Again, Respondent's prior arguments before the state court reveal the transparency of its assertions before this Court:

> It must always be borne in mind that El Paso had no real alternative to invocation of those provisions of the GLAs which allow reassignment by El Paso in the event of unprofitability and noncommerciality. It is without dispute that unprofitability and noncommerciality do not stem from high drilling costs or high operating costs which El Paso might be able to control with careful management; rather, unprofitability and noncommerciality arise solely because of the contractual obligation to pay Appellees a fixed amount per unit of gas produced and sold even though *El Paso's income stream had been forced below the level of the payments by operation of federal law.*

Brief of Appellant El Paso Natural Gas Company at 8, Supp. App. SA-3. (Emphasis added).

Respondent argued, and the Texas Court of Appeals accepted, that the abandonment of cost-of-service pricing was mandated by the NGPA as interpreted by this Court in *Mid-Louisiana*. However, this determination is incorrect as a matter of federal law. In *Public Utilities Comm'n of California v. FERC*, 817 F.2d 858 (D.C. Cir. 1987), the court specifically held that *Mid-Louisiana* did *not* mandate abandonment of cost-of-service pricing. *See also Columbia Gas Development Corp. v. FERC*, 651 F.2d 1146, 1156-57 (5th Cir. 1981). These decisions demonstrate, contrary to the opinion of the state court below, that Congress intended the NGPA to continue cost-of-service pricing unless the gas qualifies for higher incentive rates established by other pricing categories in the NGPA.[9]

The Texas court's decision stands in direct contradiction to the holdings of the Fifth and D.C. Circuit Courts of Appeal on this substantial question of federal law. Certiorari is appropriate in these circumstances where a state court decision conflicts with the decisions of federal courts on the application of federal law.[10]

3. The Decision Of The State Court Would Destroy Petitioners' Property Rights, Which Were Previously Affirmed In Federal Court.

Respondent incorrectly asserts that Petitioners' property interests were not destroyed as a result of the Texas court's decision.[11] To the contrary, the state court's decision threatens to nullify the same royalty interests

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[9] Pipelines may qualify for higher than cost-of-service rates if the gas "falls within one of the special categories of gas whose production Congress saw a need to stimulate." *Mid-Louisiana*, 463 U.S. at 343.

[10] *See, e.g.*, Edward Katzinger Co. v. Chicago Metallic Mfg. Co., 329 U.S. 394 (1947); MacGregor v. Westinghouse Electric & Mfg. Co., 329 U.S. 402 (1947).

[11] Brief in Opposition at 4.

that were affirmed, after more than a decade of litigation, in *El Paso Natural Gas Co. v. Sun Oil Co.*, 708 F.2d 1011 (5th Cir. 1983), *cert. denied*, 468 U.S. 1219 (1984) [hereinafter "*Sun Oil*"].

In *Sun Oil* the Fifth Circuit held that Petitioners were entitled to maintain their royalty interests. 708 F.2d at 1016. Under the Texas court's decision, the overriding royalty interests affirmed in *Sun Oil* would be terminated, as Respondent itself has acknowledged.[12] Petitioners respectfully submit that certiorari should be granted in order to protect their property interests and to preserve the holding in *Sun Oil*.

CONCLUSION

The state court's decision below is premised upon the court's interpretation and application of the NGPA, and the court's reading of this Court's landmark decision in *Mid-Louisiana*. By adopting Respondent's interpretation of the NGPA and *Mid-Louisiana*, the Texas Court of Appeals committed a fundamental error of federal law and created a direct conflict with substantial federal authority. Moreover, the state court's error improperly threatens the destruction of Petitioners' property rights. These rights were previously affirmed by the United States Court of Appeals for the Fifth Circuit in *Sun Oil* and should be protected under the doctrine of *res judicata*.

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[12] *Id.*

Certiorari should be granted to correct the error of federal law committed by the state court below and to preserve the integrity of the Fifth Circuit's prior judgment.

Respectfully submitted,

CHARLES M. DARLING, IV
STEVEN R. HUNSICKER
JOHN P. BABB
BAKER & BOTTS
555 13th Street, N.W.
Suite 500 East
Washington, D.C. 20004-1109
(202) 639-7700
Attorneys for Petitioners

Of Counsel:

FINA OIL AND CHEMICAL COMPANY
SCOTT SHELTON
P.O. Box 2159
Dallas, Texas 75221

CHARLES W. COLWILL,
ANNE HOME EMERSON, TRUSTEE,
ANNA LOU HOME,
TERESA HOME,
CASSANDRA KEYSER,
JEAN E. KEYSER,
BARRON KIDD, AND
HELEN ULMER VAN ATTA,
EMORY T. CORBETT
Suite 500
Two Turtle Creek Village
Dallas, Texas 75219
(214) 528-6174

MORRIS AND FLORA MIZEL
LIONEL E. Z. COHEN
309 Philtower Building
Tulsa, Oklahoma 74103
(918) 583-6211

SUPPLEMENTAL APPENDIX

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SUPPLEMENTAL APPENDIX

No. 01-84-00350-CV

IN THE COURT OF APPEALS
FOR THE SUPREME JUDICIAL
DISTRICT OF TEXAS
AT HOUSTON

EL PASO NATURAL GAS COMPANY,
Appellant,

v.

TENNECO OIL COMPANY, *et al.*,
Appellees.

On Appeal from the 11th Judicial District Court
of Harris County, Texas

BRIEF OF APPELLANT EL PASO NATURAL GAS COMPANY

ROBERT J. KING
GARY B. CONINE
D. MITCHELL MCFARLAND
PATRICIA L. JONES
LIDDELL, SAPP,
ZIVLEY & LABOON
3400 Texas Commerce Tower
Houston, Texas 77002
(713) 226-1200

DONALD J. MACIVER, JR.
ARTHUR R. FORMANEK
EL PASO NATURAL GAS
COMPANY
P.O. Box 1492
El Paso, Texas 79978
(915) 541-2600

RUSH MOODY, JR.
AKIN, GUMP, STRAUSS, HAUER
& FELD
1333 New Hampshire Ave., N.W.
Suite 400
Washington, D.C. 20036
(202) 887-4000
Attorneys for Appellant,
El Paso Natural Gas Company

FACT STATEMENT PERTINENT TO POINTS 1 THROUGH 37

This is a general fact statement pertinent to Points of Error 1 through 37 raised by Appellant El Paso, Plaintiff below. Other facts may be discussed in more detail under the points to which they are applicable.

A. Background of the Controversy

This declaratory judgment action would not have been filed, nor would the present controversy among the parties exist, were it not for the occurrence of two events totally beyond the control of the parties.

First, the "Natural Gas Policy Act of 1978" (15 U.S.C. § 3301 *et seq*) ("NGPA") was enacted by Congress and signed into law by the President. Under this far-reaching statute, it became both a civil and criminal violation of federal law to knowingly exceed the specifically listed maximum lawful prices prescribed in the NGPA, in a first sale of natural gas, whether the sale was made in interstate commerce or in intrastate commerce. 15 U.S.C. § 3414.

Second, the United States Supreme Court held that the maximum lawful price provisions of the NGPA were applicable to natural gas produced by interstate and intrastate pipelines from their own wells, even though that gas moved into the pipeline without a traditional "sale" having occurred; thus, the intra-company transfer from a pipeline's production division to its transmission division was sufficient to render pipeline production subject to NGPA price ceilings, and to make the producing pipeline subject to civil and criminal sanctions for a knowing violation of the statutory pricing structure.[3]

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[3] *Public Serv. Comm'n. of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 77 L.Ed.2d 668 (1983), *affirming Mid-Louisiana Gas Co.* v. *FERC*, 664 F.2d 530 (5th Cir. 1981) (*"Mid-La"*).

* * * *

It was El Paso's decision to exercise its rights of reassignment—of all existing wells under the "Unprofitability Clause" and of all undeveloped acreage under the "Undeveloped Acreage Clause"—that precipitated this declaratory judgment action (SF 11/30 at 58-61).

It must always be borne in mind that El Paso had no real alternative to invocation of those provisions of the GLAs which allow reassignment by El Paso in the event of unprofitability and noncommerciality. It is without dispute that unprofitability and noncommerciality do not stem from high drilling costs or high operating costs which El Paso might be able to control with careful management; rather, unprofitability and noncommerciality arise solely because of the contractual obligation to pay Appellees a fixed amount per unit of gas produced and sold even though El Paso's income stream had been forced below the level of the payments by operation of federal law (SF 11/30 at 29-30; 12/15 [p.m.] at 14-19).

* * * *

SA-4

No. 01-84-00350-CV

IN THE COURT OF APPEALS
FOR THE SUPREME JUDICIAL
DISTRICT OF TEXAS
AT HOUSTON

EL PASO NATURAL GAS COMPANY,
Appellant,

v.

TENNECO OIL COMPANY, *et al.*,
Appellees.

On Appeal from the Eleventh Judicial District Court
of Harris County, Texas

REPLY BRIEF OF EL PASO NATURAL GAS COMPANY

ROBERT J. KING
GARY B. CONINE
D. MITCHELL MCFARLAND
PATRICIA L. JONES
LIDDELL, SAPP,
ZIVLEY & LABOON
3400 Texas Commerce Tower
Houston, Texas 77002
(713) 226-1200

DONALD J. MACIVER, JR.
ARTHUR R. FORMANEK
EL PASO NATURAL GAS
COMPANY
P.O. Box 1492
El Paso, Texas 79978
(915) 541-2600

RUSH MOODY, JR.
AKIN, GUMP, STRAUSS, HAUER
& FELD
1333 New Hampshire Ave., N.W.
Suite 400
Washington, D.C. 20036
(202) 887-4000
Attorneys for Appellant,
El Paso Natural Gas Company

* * * *

In contrast to *Sun Oil*, El Paso seeks in this proceeding to obtain a declaration that, on August 1, 1983, El Paso validly exercised its option set forth in the GLAs to reassign unprofitable wells and non-commercial undeveloped acreage to Appellees, and that certain overriding royalty interests had converted to working interests. This Court will surely recognize that of paramount importance in evaluating this claim is the simple fact that unprofitability did not exist until long after the Midland District Court trial had ended, and long after the FPC proceedings had been concluded. Factually, unprofitability occurred only because of the Natural Gas Policy Act of 1978 as definitively interpreted by the United States Supreme Court in *Mid-La*[6] in 1983. If unprofitability did not exist until 1983, it could not have been litigated in the 1973-1975 prior litigation between these parties.

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[6] *Public Service Commission of New York* v. *Mid-Louisiana Gas Co.*, 463 U.S. 319, 72 L.Ed. 2d 668 (1983).